

## LEGAL ASPECTS OF THE FOREIGNNESS OF FOREIGN INVESTMENT

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Crystal gazing seems fair sport for an anniversary occasion. I take it that the theme of this gathering and the focus of its discussion testifies to the belief that the crucial international legal relations of the next fifty years will burst the bounds traditionally described by either public or private international law, narrowly defined. Since law, especially American law, is a problem solving process, it can be expected that the challenges and advances of international legal relations over the next fifty years will spring from the international problems which lawyers are asked to help solve. So in searching for the future direction in the international economic field we might well ask what are the top priority problems to which our profession might contribute a solution?

The economic dilemmas and opportunities which Dr. Diamond has so ably portrayed are so overwhelming, so dramatic, that it is easy to lose track of the law in them. The law's role in economic development is so obvious, so taken for granted, that it rarely receives special analysis. But if savings are to be translated into investment—the essence of the economics of growth—the saver must have legally enforceable assurance that the investor will be accountable to him. What, then, are the special problems posed for this law job when savings in one country are sought for investment in another?

Of course I cannot adequately answer my own question. But I would like to point out some problems and perhaps suggest some emphasis which are too often neglected. Perhaps it will help if we think separately of the challenge to the private lawyer—the business counsellor and negotiator—; the challenge to the public lawyer concerned with the regulation of business; and the challenge to what might be called the promotive lawyer—the lawyer concerned with directly stimulating the kind of economic development Dr. Diamond was speaking about.

### *Foreignness and the private lawyer*

Perhaps the most enduring, certainly the most pervasive constructive contribution the American legal profession can make to international economic legal relations is in the day-to-day exercise of traditional professional ingenuity in devising the numberless credit, licensing and investment transactions without which no investment would be offered or accepted.

Superficial surmise might lead some to believe that the American counsellor is less important in an international transaction than in a domestic one because of the foreignness of foreign business. My impression is quite the contrary. The reasons are not hard to fathom. First, of

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course, the American lawyer knows better than any foreign lawyer possibly can the interests, needs, legal possibilities and legal limitations of an American investor. Second, and perhaps more important, two hundred years of business counselling across state lines in the world's fastest growing economy have vested the American legal profession with a tradition of architectural ingenuity and a variety of experience which is itself an important reservoir of "knowhow." Of course it has its counterparts in other developed countries, if not always in law, in other callings related to business and finance. But, especially in the development of less mature economies, the American lawyer can be expected to help creatively in devising the instruments and institutional arrangements which large scale capital formation requires. It is not a question of exporting the American legal system. Rather, it is an opportunity to adapt whatever may be useful from our own experience to systems which may never have contemplated the demands and possibilities of large and complex capital transactions. Examples come to mind. Flexibility in amount and form of the capitalization of an enterprise may seem hamstrung by some aspects of the traditional civil law company laws. Our experience with convertible debentures, stock options, escrow agreements, voting trusts and no par value stock may suggest possibilities consistent with but not contemplated by local law. In face of the often understandable resistance to foreign ownership, licensing arrangements, management and technical service contract possibilities may permit the devising of "investments by contract" which will satisfy the needs of the investor's security and still be palatable to the desire for local ownership. In the area of "knowhow" licensing especially there is great economic promise which may be enhanced by trying to draw upon the suggestive experience of equity jurisprudence in general and the special concepts of unfair competition in particular. In the field of minerals development, there is the crucial challenge to legal ingenuity posed by the investor's interest in long run assurance of control and product availability on the one hand and the resource country's fear of exploitation on the other. In face of rising "resource nationalism," almost always buttressed by the foreign state's legal title to the subsoil, traditional concepts of ownership may be a less important form of security than concession agreement drawn with the foresight which minimizes friction by anticipating the interests which are bound to conflict if exploration brings in a "find" exceeding the initial expectations of both parties.

Throughout the gamut of the most crucial investment relationships, then, the American lawyer faces a challenge to his talent certainly comparable to, if not greater than, the challenge posed by the development of the United States. Precisely because of the tradition of the American corporate bar, which sees the lawyer as planner, counsellor, negotiator, as well as draftsman and advocate, the challenge is perhaps at the top of our agenda.

*Foreignness and regulatory law*

If all law is "territorial" it might be asked why are one country's investments in another any concern of its regulatory law? Why should "foreignness" have anything to do with government control of business. Territoriality made understandable sense when the Harvard Research produced its draft convention on jurisdiction with respect to crime in 1935.<sup>1</sup> It may still make sense, but the strains upon it could not have been contemplated by an International Court adjudicating the power of the Turkish government to determine the responsibilities of the French officer of the watch on the S.S. *Lotus* when Turkish sailors were killed in a collision with a Turkish vessel on the high seas.<sup>2</sup> In a world where most nations' standards of living and national security alike depend so heavily on what goes on in other countries it is inevitable that a nation's law should be tempted to reach out to govern the activities abroad which affect it—especially the activities of its own nationals. The enforcement of a freely competitive market at the one extreme or the maintenance of effective export, import, or exchange control at the other extreme alike may urge an effort to hold nationals, residents or even foreigners to account for the conduct of their foreign commercial and monetary affairs.

Notions of exclusive jurisdiction on a territorial basis cannot answer the problems posed by the multi-national transaction and the multi-national corporation. "Proper law" rules may offer a clue, but concepts adequate for contract, tort, and family law cannot adequately govern relations among parties and governments when the state feels that a crucial national economic interest is at stake. One example will suffice. We might insist in the name of mutual security that it is proper at least to attempt to govern shipments of strategic goods to the cold war enemy by any foreign affiliate of an American national or resident.<sup>3</sup> But we would probably object strenuously if an Arab state told an American oil concessionnaire that he could not ship oil to Israel produced by him in Venezuela. Such dramatic incidents will of course not be solved by legal concept. But if an economically interdependent alliance of free nations with competing economic interests and contrasting economic policies is to achieve a normal harmony beyond the needs of crisis, some rationale must emerge which takes account of the foreign extension and impact of regulatory law.

*Foreignness and economic aid.*

Private international legal relations and conflict of regulatory law may not seem to have anything to do with the larger issue of world economic development to which Dr. Diamond addressed his thoughtful

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<sup>1</sup> 29 AM. J. INT'L L. (Supp. 2) 437 (1935)

<sup>2</sup> PJIC, Series A, No. 9.

<sup>3</sup> Title 31, Ch V, Foreign Assets Control Repts. 500.329, 500.330; Fed. Reg. (1954) 5482.

paper. However, it is fair to guess that private international investment and the legal context in which it functions will have its vital contribution to make to the world's chances for economic growth alongside of public international investment or the other governmental devices loosely called foreign aid.

I suspect that I am more favorably inclined toward public international lending, public technical assistance, and intergovernmental grants than are the majority of my fellow countrymen. And I accept Dr. Diamond's persuasive analysis of the obstacles to large scale private international developmental investment. However, I would like to suggest some of the reasons why traditional intergovernmental aid along Marshall Plan lines seem to me also an inadequate solution. To keep to my chosen theme, it has to do with the foreignness of foreign aid. To look at the other side of Dr. Diamond's coin, it has to do with the "climate" of the investing, the developed countries, particularly the United States. The grantor's state of mind is no less a fact of international economic life than is the attitude of the recipients of investment.

The political symptoms of reluctance to engage in massive foreign assistance are familiar; first, we do not want to pay more taxes or inflate domestic prices; second, we do not think that the grantor-grantee relationship is conducive to the good political relations which are among the reasons for the aid in the first place. Whatever may be the truth of these assertions, I think they do not adequately express the fundamental, and I would say proper, basis for skepticism about massive public international investment or grant aid.

*a) Dispersion of initiative.*

The American presumption in favor of private enterprise is more than an inherited bias. It is a conviction borne of relative success. Although too often couched in terms of private rights, it also expresses a rational notion that more is likely to get done faster if you have a dispersion of separate centers of initiative devoting their energies and imaginations to the same problem, than if you have initiative dependent on the permission of central authority demanding conformity to its plan. Also practical action judgments and decisions may well be better made by the people actually working close to the problem than by those at some remote central bureau.

Now obviously the presumption can be overridden, especially in those jobs and areas where there is no opportunity to give play to competing judgment and enterprise, or those areas where the calculus of the private fair return cannot operate because it is not feasible to charge through the market mechanism all those who benefit. But the presumption remains, and a rational, long-run economic footing can be claimed for it.

*b) Dispersion of blame*

In the last analysis, the economic basis for the free enterprise method

of economic organization and operation may be less significant than its social and political underpinning. To put it most simply, it is the notion that when things turn out badly, it is better to have resentment localized and distributed than to have it fester into an eruption which may rip apart the entire political, social and economic fabric. Best of all it hopes that failure will, as often as possible, be a matter of self blame. At worst it urges that disappointment should not give rise to a justified feeling that opportunity was rigged by private status or public favor.

*c) Foreignness and dispersion of initiative*

Such large concepts so crudely over-simplified must surely seem far removed from the challenge which foreignness poses for foreign aid. However, if among our ultimate objectives in foreign economic policy is the speedy creation of capital and managerial potential, and the creation and maintenance of political stability and the minimizing of justified resentment against the haves by the have-nots, the rationale I have suggested for the private enterprise approach takes on special meaning in the international context.

Much is heard about attaching no strings to foreign aid. However, even if economic assistance is properly divorced from crude demands for military alliance or demands for groveling gratitude, there is no such thing as the "stringless" loan or grant. No politically accountable keeper of the public purse can, or should, afford to be unconcerned with getting the people their money's worth, even if that worth is defined in most laudable, disinterested terms. Programming and rationing choices have to be made. Each increment or modification of the original plan must be newly justified. Performance has to be checked. Audits have to be required. Initiative must wait upon approval at the desks of government economists and engineers and comptrollers.

The red tape of advance approval can be minimized if, as in the Marshall Plan, assistance can be furnished to developed industrial economies through normal banking channels. Specific investment decisions can then be left to the rationing of the normal functioning commercial market. But when assistance is bestowed upon economies which in common parlance are underdeveloped, the recipient government must turn around and through its political processes directly hire from abroad much of the talent it needs. So, advance selection and ex-post check up must be made by two governments, both politically accountable to their ever vigilant often scapegoat-minded opposition critics. Freedom of initiative from direct political accountability may in this context be even more crucial between nations than within them. At least it may underscore a presumption in its favor, albeit rebuttable in many cases of social overhead investment which cannot be made to charge its users for its cost.

*d) Foreignness and dispersion of blame*

Within any democratic country the drawbacks of public investment or public lending can be mitigated by the representative political process.

Wasteful error of planning or management, or egregious favoritism can receive its retribution at the polls. Resentment there may be, but it can find its own orderly cure.

In the international context, however, the essence of "foreignness" is that neither grantor nor grantee has an acknowledged voice in the political process of the other. Even if there were no risks of spendthrift waste or abusive favoritism (common enough in even the most mature politics), planners, disbursing officers, contractors, managers, engineers are fallible. In any job as large as that of trying to create the means to a decent life for the world's underprivileged majority, there are going to be mistakes—reasonable, normal, human, expensive mistakes. It is vital that the disappointment at best and resentment at worst which will fester in the minds of those who gave, those who received and those who asked but were turned down not be directed by the peoples and government of one nation against the peoples and government of another, any more than absolutely necessary. Yet in a regime of massive intergovernmental lending which departs from banking criteria what is more normal than for each government to deflect its peoples' criticism to the other government or governments involved?

Dispersion of blame among channels of private bargaining is even more important internationally than at home.

*The challenge of foreignness to foreign economic policy, a projection by way of conclusion.*

Unfortunately, I agree with Dr. Diamond's gloomy analysis of the barriers to private international investment. Since I also agree with my own gloomy analysis of the obstacles to very large scale public international loans or grants, I am not left in a very constructive posture in which to face the human challenge of economic development, dramatized by but scarcely created by the Soviet's economic bid for the allegiance of the uncommitted world.

However, political wisdom and legal ingenuity in the devising of techniques helped bring us through the Great Depression and the Total War without sacrificing our fundamental rationale of social and economic organization. Many of the values of the privateness of private business have been maintained even while inducing it to do things in the public interest by techniques of loan, guaranty, and subsidy. Such techniques of "riskless capitalism" have their own notorious drawbacks—windfall profits and domestic political favoritism not the least among them. Perhaps worst of all is the favor that doesn't induce anything, or which goes to those who would have acted anyway.<sup>4</sup> On the other hand assistance which too narrowly defines the risk coverage or which requires interminable negotiations with government may well rob the inducement

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<sup>4</sup> My own impression of many proposals to exempt foreign income from U. S. Taxes.

of its effect and deprive the private enterprise of the initiative which is its justification.<sup>5</sup>

Concrete solutions naturally defy generalization, for foreign investment in the public interest is many distinct things. My own notions are too underdeveloped to warrant your prolonged attention or my risk of their incomplete statement. However, to point the direction of thought which seems to me useful:

(1) I would think the FHA loan guaranty approach, including intra-corporate loans, would do much to afford American firms the leverage position which would induce the foreign investment not only of dollars but of scarce technical and managerial personnel. These are sorely needed for their general contribution of technical and entrepreneurial skill whether or not the enterprise itself would rate high on a planner's priority list.

(2) In the area of public service investment, or investment in any industry which is such a fulcrum of a nation's economy that perpetual foreign ownership may be unpalatable, it is not impossible that an initially private investment could be made subject to an "anticipatory nationalization agreement" whereby a royalty, fee, or profit-sharing interest in the going concern value of the enterprise could be assured the investor even if he were, after some stated period, deprived of the symbol of ownership.

(3) In the area of raw materials the problem seems to me quite special. No spur is needed to cultivate an interest in investment. Rather, the problem is to induce resource countries to accept investment and permit it to remain on reasonable terms once reserves are brought into being and production. Here perhaps the approach should be to find a way whereby the investor could be the conduit for social overhead and other developmental investment which an underdeveloped resource country sorely wants. This, however, would involve political as well as economic and financial risks which inhibit me from saying more until it is better thought through.

These notions would require much more amplification and testing before they could rise to the dignity of definite proposals. They are offered here only in an illustrative sense, to indicate that there is still room for constructive response to what seems to me the crucial challenge posed by the foreignness of both foreign aid and foreign private investment.

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<sup>5</sup> My own impression of the reason for the relative inconsequence of the U. S. government offer to guarantee against inconvertibility of foreign earnings and expropriation of foreign assets.